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Section 103 of the Revenue Act of 1971 and the Houdaille Case: A New Trade Remedy?*

by Patrick F. J. Macrory**
and Kenneth I. Juster***

On May 3, 1982, Houdaille Industries, Inc. (Houdaille), a U.S. machine tool manufacturer, filed a petition with the U.S. Government requesting that the President suspend indefinitely the investment tax credit available to purchasers of numerically controlled machining centers and punching machines imported from Japan. The petition was based on Section 103 of the Revenue Act of 1971, which gives the President authority to deny application of the investment tax credit on imported articles when the government of the exporting country "engages in discriminatory or other acts (including tolerance of international cartels) or policies unjustifiably restricting United States commerce." The petition alleged that the Government of Japan had for many years fostered a cartel among Japanese machine tool manufacturers, which had given them an unfair advantage in competing with American manufacturers in the U.S. market.

After nearly a year of deliberation, on April 22, 1983, the U.S. Government announced without explanatory comment, that it had "decided

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* Some of the ideas expressed in this article first appeared in an article published (in Japanese) at 10 J. JAP. INST. OF INT. BUS. L. 358 (1982).

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to deny the relief requested in the petition filed by Houdaille." At the same time, it stated that it intended to pursue with the Japanese Government the issues raised by the Houdaille case and that, as part of this effort, officials from the two countries would hold talks on Tokyo's industry-related policies and their impact on trade. The Administration did not rule out the possibility of further action in the future regarding the allegations in the Houdaille petition.

The petition by Houdaille was the first time that Section 103 of the Revenue Act of 1971 had been invoked. Indeed, prior to its filing this provision had been ignored or overlooked by lawyers engaged in international trade. It was unfortunate, therefore, that the U.S. Government failed to explain its denial of the relief requested by Houdaille. As a result, many of the issues raised about Section 103 as a possible trade remedy available to domestic industries seeking to restrict imports into the United States were left unanswered. This article addresses several of those issues in the context of examining the Houdaille case.

The article is divided into two principal sections. The first section discusses the background and substance of the Houdaille petition; the second section discusses some of the important issues regarding Section 103 which are raised by this case. The article concludes that, although Section 103 was not an appropriate trade remedy under the circumstances of the Houdaille case, it remains a potential tool for import relief in more limited circumstances when other trade statutes are inapplicable.

3 Office of the U.S. Trade Representative, Press Release, Brock Announces Decision on Houdaille Petition (Apr. 22, 1983). The entire announcement was as follows:

The United States Trade Representative William E. Brock announced today that the United States Government has decided to deny the relief requested in the petition filed by Houdaille Industries, Inc., under Section 103 of the Revenue Act of 1971.

The petition did raise questions concerning the possible effects on U.S. commerce of certain Japanese practices. For this reason, while denying the relief requested, Ambassador Brock announced that he will begin consultations with the Government of Japan concerning these practices. Japan has committed to begin such talks immediately. Ambassador Brock further stated 'It is important that these discussions effectively deal with these problems, making further action unnecessary.'

4 Id. The bilateral committee formed for these discussions is known as the U.S.-Japan Committee on Industry-Related Policies and Their Impact on Trade. The first of what is expected to be a bimonthly series of meetings was held in Japan on May 14-16, 1983. Deputy U.S. Trade Representative Michael Smith led the U.S. delegation; Kunio Komatsu, Vice Minister of the Ministry of International Trade and Industry ("MITI"), led the Japanese delegation. There are reportedly three phases planned for the discussions: (1) understanding the constituent elements of Japan's industrial policy; (2) determining what elements, if any, affect trade with the United States; and (3) making appropriate policy recommendations on how the U.S. should respond. 98 DAILY REP. FOR EXECUTIVES L-10 (BNA)(May 19, 1983); 19 INT'L TRADE REP. EXPORT WEEKLY 201 (BNA)(May 10, 1983); 81 DAILY REP. FOR EXECUTIVES LL-2 (BNA)(April 26, 1983).
I. Background and Context of the Houdaille Case

A. The Machine Tool Industry in the United States

Machining technology is at the very base of the way of life in an industrialized society. Almost all manufactured products used today are in some way dependent on machine tools or on machines built by machine tools. There are numerous types of machine tools, which vary in size and in types of work they perform. The diverse nature of machine tools ranges from boring, grinding, and threading implements to pressing, bending, and die-casting devices. One of the more significant recent developments in machinery technology has been the introduction of numerically controlled units. Numerical control is a method of accurately controlling the movement of machine tools by a series of programmed numerical data which activate the motors of the machine tool. Punched cards or tape provide numerically controlled machines with detailed information regarding the particular part to be produced. The machine decodes this punched information and electronic devices activate the various motors on the machine tool, causing them to follow specific instructions.

The two types of machine tools covered by the Houdaille petition are numerically controlled machining centers (n.c. machining centers) and numerically controlled punching machines (n.c. punching machines). Houdaille is one of the domestic manufacturers of n.c. machining centers and n.c. punching machines.

Although the early development in the United States of n.c. machine tools gave the U.S. industry a substantial lead over foreign competitors in international markets, and enabled the United States to maintain its world leadership in machine tool exports, that situation has changed dramatically in recent years as foreign manufacturers, especially the Japanese, have made advances in machining technology. Not only has the U.S. machine tool industry's share of world exports steadily declined over the last two decades, but the industry has suffered a significant loss of its own domestic market share. Since at least 1981, it has experienced a decreasing backlog of orders, low levels of new orders, and increased pressures from imports.
The shifts in market size and share have been especially pronounced with respect to n.c. machining centers and n.c. punching machines. The size of the domestic market for n.c. machining centers more than tripled between 1976 and 1981. While the total volume of sales by U.S. manufacturers also grew during this period, though at a somewhat slower rate, the market share of the same manufacturers declined from ninety-five percent in 1976 to slightly under fifty percent in 1981. In contrast, the Japanese share of the U.S. market rose from less than four percent in 1976 to fifty percent in 1981.11

Similar trends are apparent in the n.c. punching machine market. The size of the domestic market for n.c. punching machines doubled between 1976 and 1981. Although the total volume of sales by U.S. manufacturers also grew during this period, the relative market shares of U.S. and Japanese companies shifted greatly. With these shifts in market share, the U.S. machine tool industry now finds itself in a troubled state. Officials of the National Machine Tool Builders' Association contend that some form of import relief is a necessary element to the economic recovery of the industry.12

B. Japanese Industrial Policy

The Houdaille petition was in essence an attack on the successful application of industrial policy by the Government of Japan to the Japanese machine tool industry. Indeed, it is significant that the one affirmative step the U.S. Government took when it denied the Houdaille petition was to initiate discussions with the Government of Japan regarding Tokyo's industry-related policies and their impact on trade.13

Industrial policy is generally defined as the application of government resources and influence to promote selected, vital industries within a state.14 The objective of industrial policy is to raise the real income of the population by shifting resources to those sectors of industry in which they can be most productive. The guiding principle behind industrial

12 Cole, Tool Order Drop Cited for April, N.Y. Times, May 30, 1983, at 35. Interestingly, however, the Association did not join in the Houdaille petition. It instead filed a petition under Section 232 of the Trade Expansion Act, 19 U.S.C. § 1962(b) (1982), seeking import relief on the ground that imports of machine tools are endangering the national security of the United States. It has been reported that the Department of Commerce, which is charged with carrying out investigations under § 232, has made an affirmative recommendation to the President, but that other agencies including the Departments of State and of Treasury, the Office of Management and Budget, and the Council of Economic Advisers, are opposed to granting import relief. See INSIDE U.S. TRADE, March 16, 1984, at 1.
13 See supra note 4.
policy is that of international competitive advantage; a country’s real industrial wage can rise substantially over time only if its labor and capital flow toward increasingly higher-value added, higher productivity industries.\textsuperscript{15}

The basic aim of industrial policy, therefore, is to identify the best way to encourage growth, or to adjust to the decline, of a particular sector of the economy. The tools employed in industrial policy include the following: credit rationing; favorable access to investment funds and foreign exchange; the use of rationalization cartels; joint research and development programs; control over licensing of technology; use of tariffs, quotas, and export controls; and administrative guidance.\textsuperscript{16}

The Japanese have taken industrial policy seriously, from their initial industrialization following the Meiji Restoration of 1868, up through the present, with particular emphasis during the post-World War II period.\textsuperscript{17} According to one set of commentators, the three main elements in Japanese industrial development are the following:

(i) recognition of the country’s need to develop a highly competitive manufacturing sector;

(ii) the deliberate restructuring of industry over time towards higher value added, higher productivity industries. (The Japanese call these industries “knowledge intensive”);

(iii) aggressive domestic and international business strategies.\textsuperscript{18}

In the face of widespread industrial destruction and critical shortages of capital following World War II and the Occupation, Japan undertook the restructuring of its economy by encouraging and facilitating investment in industries considered basic to an industrialized economy. During the early postwar period, the Japanese marshalled an impressive array of industrial policy instruments to foster investment-led growth. Significant financial support for industrial development coupled with extensive controls over trade and capital flows constitute the foundation upon which Japan grew to be an economic power. Throughout the 1970s, as the Japanese economy grew in size and strength, Japan began to dismantle many of its industrial policy tools in response to pressure from its major trading partners.\textsuperscript{19}

One sector which has received attention from the Government of Japan since World War II is the machinery industry, including the manufacturing and producing of machine tools. Specifically, the Japanese Diet has enacted three “Temporary Measures Laws” designed to stimu-


\textsuperscript{17} The United States, by contrast, has taken the free market/regulatory path to industrial development. See \textit{Staff of Subcomm. on Economic Stabilization, Comm. on Banking, Finance, and Corporate Affairs, 98th Cong., 1st Sess., An Industrial Policy for America: Is It Needed?} 23 (R. Reich) (Comm. Print 1983).

\textsuperscript{18} I. Magaziner & T. Hout, supra note 15, at 4.

late and promote the development of the machinery industry: the Law for Temporary Measures to Promote the Machinery Industry (enacted in 1956; expired in 1971); the Law for Temporary Measures to Promote Specific Electronic Industries and Machinery Industries (enacted in 1971; expired in 1978); and the Law for Temporary Measures to Promote Specific Machinery and Information Industries (enacted in 1978).20

The Ministry of International Trade and Industry ("MITI") has been the government organ empowered by the Temporary Measures Laws to implement the policies expressed in those laws.

As authorized by the Temporary Measures Laws, the Japanese Cabinet designated certain machine tools as among those products covered by the laws. MITI then exercised its power under the Temporary Measures Laws to instruct machine tool companies to cooperate in specific areas in order to fulfill the purposes of the laws.21 The actions taken by Japanese machine tool companies, therefore, had to comply with MITI's instructions, and,理论上, could neither be detrimental to the interests of consumers or to those enterprises engaged in related industries, nor be unfairly discriminatory.22

The Japanese Diet also enacted the Export and Import Trade Law in 1952 to promote the sound development of foreign trade by establishing an orderly system for export and import trading. MITI again is the government organ empowered to implement the policies expressed in the Export and Import Trade Law. Under the law, MITI can instruct the relevant Japanese industry or exporters' association to enter into arrangements necessary to promote foreign trade in an orderly fashion. According to the petition, MITI did just that in 1977 in connection with the export of certain n.c. machining centers and n.c. lathes to the United States and Canada, when it instructed Japanese exporters of those machine tools to enter into an arrangement under Article 11, Paragraph 2 of the Export and Import Trade Law. In compliance with these instructions, the Japan Machinery Exporters' Association, which includes exporters of n.c. machining centers and n.c. lathes among its members, made arrangements in March, 1978 with respect to minimum prices and other matters related to exports in North America. These arrangements were to conform with Japanese antitrust laws.23

C. Section 103 of the Revenue Act of 1971

In seeking a trade remedy, Houdaille chose to look beyond those
Statutes traditionally available for regulating foreign trade, such as the countervailing duty law\(^{24}\) or the escape clause.\(^{25}\) Instead, Houdaille invoked a relatively unknown statute which had never before been used as a trade remedy: Section 103 of the Revenue Act of 1971.\(^{26}\) This was an important development because it opened up the possibility that Section 103 could become a powerful new weapon in the arsenal available to domestic industries seeking to restrict imports into the United States.

Section 103 of the Revenue Act of 1971 added Section 48(a)(7) to the Internal Revenue Code's provisions on the investment tax credit. The investment tax credit is a benefit which permits a taxpayer to credit against income tax a certain percentage of amounts invested in qualified depreciable property. Subsection 48(a)(7)(D) grants the President of the United States authority to exclude certain property either completed abroad or predominantly of foreign origin from qualifying for the investment tax credit. The text of subsection 48(a)(7)(D) provides as follows:

> "If, on or after the date of the termination of Proclamation 4074 [December 19, 1971], the President determines that a foreign country—
> (i) maintains nontariff trade restrictions, including variable import fees, which substantially burden United States commerce in a manner inconsistent with provisions of trade agreements, or
> (ii) engages in discriminatory or other acts (including tolerance of international cartels) or policies unjustifiably restricting United States commerce,
> he may provide by Executive order for the application of subparagraph (A) [excluding foreign-produced property from eligibility for the investment tax credit] to any article or class of articles manufactured or produced in such foreign country for such period as may be provided by Executive order."\(^{27}\)

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\(^{24}\) The countervailing duty law, 19 U.S.C. § 1671 (1982), is designed to offset the effect in the U.S. market of the subsidization of imports by foreign governments. If the petitioning domestic industry can establish that the products imported into the U.S. have benefited from a subsidy and that, in the case of countries which have signed the Tokyo Round Agreement on Subsidies and Countervailing Duties, the domestic industry has been materially injured or threatened with material injury, the U.S. Government must impose a countervailing duty equal in amount to the margin of subsidization.

\(^{25}\) Section 201 of the Trade Act of 1974, 19 U.S.C. § 2251 (1982), known as the "escape clause," is designed to provide import relief to the industry in question while the industry adjusts to new competitive conditions. If the petitioning domestic industry can establish that imports are increasing and that the increased imports are a "substantial cause" of serious injury to the industry, then the President has discretion to choose the measure best suited to facilitate the orderly adjustment to new competitive conditions.


> Property shall not be treated as section 38 [i.e., qualified] property if —
> (i) such property was completed outside the United States, or
> (ii) less than 50 percent of the basis of such property is attributable to value added within the United States.

One of the main differences between the two criteria is that subsection 48(a)(7)(D)(i) requires the action by the foreign country to be in violation of a trade agreement, while subsection 48(a)(7)(D)(ii) does not. The latter merely requires "discriminatory or other acts (including tolerance of international cartels) or policies unjustifiably restricting United States commerce." Although this criterion includes any act or policy of a foreign government that has the effect of unjustifiably restricting United States commerce, there is explicit reference to two types of conduct: discriminatory acts and tolerance of international cartels.

The Houdaille petition focused on the "tolerance of international cartels" language. It argued, by examining various pieces of U.S. legislation, that this expression referred "not only to the tolerance of cartels with transnational membership, but also to the tolerance of domestic cartels with international effects." The petition then interpreted the "restricting United States commerce" language to mean "a curtailment of sales by U.S. companies or the displacement of such business by sales of foreign products." Houdaille argued that such a curtailment is "unjustifiable" if either the restriction itself adversely affects the nation's economy and security, or the restriction is the result of governmental policies or practices that are inconsistent with U.S. public policy. According to the petition, denial of the investment tax credit would result in a 15.2 percent increase in the cost to U.S. companies of Japanese-produced n.c. machining centers and n.c. punching machines.

D. The Allegations in the Houdaille Petition

The Houdaille petition alleged that the Japanese Government had engaged in a variety of "discriminatory or other acts" which had unjustifiably restricted U.S. commerce in violation of Section 103. The most significant of these were as follows:

1. Cooperative Activities. The petition claimed that pursuant to the Temporary Measures Laws, starting in 1956, MITI had encouraged or directed the industry to take a series of rationalization measures designed to increase the competitiveness of the industry. The petition claimed, for example, that in 1968 MITI directed that each machine tool manufacturer stop manufacturing those machines for which its share in the industry was less than five percent and the production of which represented less than twenty percent of the company's total production. The purpose

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28 Petition, supra note 1, at 39-42.
29 Id. at 42-45 (emphasis added).
30 Id. at 45. The petition also argues that because Congress chose to refer specifically to discriminatory acts and to tolerance of international cartels, special legal consequences should attach to these actions; that is, where these acts are shown prima facie to restrict U.S. commerce, they should be deemed to satisfy per se the criteria of § 48(a)(7)(D)(ii). Petition, supra note 1, at 45.
31 Id. at 150-55. Unless otherwise noted, "Section 103" will refer only to subparagraph (D) of Section 48(a)(7) of the Internal Revenue Code.
of this directive was presumably to concentrate manufacturing of particular types of machines with those companies which had larger (and therefore more efficient) production runs.32 The petition also alleged that until 1970, in furtherance of this directive, no member of the Japan Machine Tool Builders' Association could manufacture a new type of machine without permission from the Association.33 The Association relaxed this rule in 1970, but still requires each member planning to introduce a new product to notify the Association, which permits comments by other members, followed by an attempt at conciliation should any member object to the introduction.34

Other actions taken by MITI under these laws, according to the petition, are the promotion of joint activities in the fields of production, marketing, and exportation, the promotion of joint research, and the promotion of standardization within the industry.35 The petition claimed that the cooperative activities of the Japanese machine tool industry had received formal or informal exemption from the Japanese antimonopoly law.36

2. Export Prices. Another major element of the complaint was the charge that, under the authority of the Export and Import Trading Law, an export trading association was established in 1978 to regulate the prices of exports of n.c. lathes and machining centers to the United States and Canada.37 According to the complaint, MITI has required every exporter to obtain specific approval for the price of each product exported to the United States. An internal guideline referred to in the petition suggests that MITI has established a minimum price for such sales, but the petition argued that this may in fact be a ceiling price.38

3. Tax Concessions, Loans and Grants. The petition described a number of special tax concessions which it claimed had been granted to Japanese machine tool makers. These include special depreciation deductions, tax export incentives, and the allowance of certified tax reserves for overseas market development.39 The petition further claimed that the Japanese machine tool industry had received special concessionary loans from the Japan Development Bank, the Small Business Finance Corporation, the Industrial Bank of Japan, the Long-Term Credit Bank, and the Japan Research Development Corporation.40 In addition, according to the petition, the industry had received grants from

32 Id. at 63-69.
33 Id. at 70-71.
34 Id. at 73-76.
35 Id. at 78-81, 83-87.
36 Id. at 89-91.
37 Id. at 91.
38 Id. at 94-96.
39 Id. at 96-102.
40 Id. at 102-09.
the proceeds of wagering on cycle and motorcycle racing, based upon a 1948 law.41

E. The Decision-Making Process Within the U.S. Government

No formal mechanism existed within the Government for handling complaints under Section 103 of the Revenue Act of 1971. The Houdaille case, therefore, was handled in the same manner as petitions filed under the similarly worded Section 301 of the Trade Act of 1974, which permits U.S. companies to file complaints when they believe that discriminatory or unfair acts of foreign governments are interfering with U.S. commerce.42 Procedurally, this meant establishing a staff-level interagency task force under the auspices of the Cabinet-level Trade Policy Committee to review the case. The task force was chaired by the official in the Office of the United States Trade Representative (USTR) who chairs the Section 301 interagency task force—an Assistant General Counsel of the Office of the USTR. Other members of the interagency group included representatives from the Departments of Treasury, State, Commerce, Labor, Defense, and Justice, as well as from the Council of Economic Advisors, the National Security Council, and the Office of Management and Budget.43

As deliberations were going on within the task force, the Senate, on December 21, 1982, passed a sense-of-the-Senate resolution urging the President to act affirmatively on the Houdaille petition. The resolution, sponsored by Senator Charles Grassley (R-Iowa), a member of the Senate Finance Committee, and co-sponsored by twenty-six other senators, declared that “the Government of Japan has selected the United States high technology industry in numerically controlled machine tools for domination through unfair trade practices.”44 The resolution called for a denial of the investment tax credit for Japanese-manufactured n.c. machining centers and n.c. punching machines “until the Government of Japan provides persuasive evidence to the President of the United States that these and other unfair and discriminatory acts and policies unjustifiably restricting United States commerce have ceased.”45

Despite, or perhaps because of, this pressure from the Senate, the interagency task force was unable to reach a consensus in the Houdaille case for some time. Moreover, one Senator, Steven Symms of Idaho (R), reacted strongly against the Senate resolution when he introduced into

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41 Id. at 109-14.
42 Trade Act of 1974, § 301, 19 U.S.C. § 2411(a)-(b) (1982) authorizes the President to retaliate against such acts by imposing quotas or other import restrictions on imports from the country in question if negotiation with the foreign government fails to produce a satisfactory resolution. See also Petition, supra note 1, at 63-69.
44 See S. Res. 525, 97th Cong., 2d Sess., 128 CONG. REC. S15961, S15991 (Dec. 21, 1982).
45 Id.
the record on January 26, 1983, a report published in late 1981 by the National Machine Tool Builders' Association (NMTBA), of which Houdaille is a member. The NMTBA report concluded that:

the strong competition from the Japanese machine tool industry is primarily the result of the willingness of management to invest heavily in its future, market its products aggressively throughout the world, work doggedly toward long-term goals, and pay an unusual amount of attention to the training and motivation of its workforce.

Also, at about this time, the attorneys for three Japanese trade groups submitted a special letter to the USTR complaining that the Houdaille proceeding had become “irreparably tainted and impaired” by procedural irregularities. The letter referred in particular to the USTR’s failure to respond to a request for a hearing, ex parte meetings that had not been made public, written submissions to the USTR office that also had not been made public, and remarks by an official from the Commerce Department suggesting that the Houdaille investigation was being improperly influenced by such extraneous political considerations as the Senate resolution.

The U.S. Government made no formal response to the letter from the Japanese trade groups, and by March 1983 had still not reached a decision in the Houdaille case. In light of the Government’s inaction, the NMTBA opened a second front in the battle against imports on March 10, 1983, by filing a petition with the Commerce Department under Section 232 of the Trade Expansion Act of 1962. That statute authorizes the President to “take such action, and for such time, as he deems necessary” to effect relief from the imports when an article is being imported into the United States in such quantities or under such circumstances as to threaten to impair the national security. The petition by the NMTBA argued that the machine tool industry was critically important for national defense and that the current level of machine tool imports impaired the national security. The NMTBA requested that the Government limit foreign producers of machine tools to 17.5 percent of the domestic market over a five-year period.

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48 The three trade groups are the Japan Machine Tool Builders' Association, the Japan Metal Forming Machine Builders' Association, and the Japan Machinery Exporters' Association.


51 NMTBA Petition, supra note 50, at 220. As noted above, see supra note 12, it has been
The NMTBA petition may have defused some of the pressure on the U.S. Government to take action against Japanese-produced machine tools under the Houdaille petition. In any event, one month later, on April 22, 1983, the Government issued a terse statement denying relief in the Houdaille case and stating instead its intention to pursue discussions with the Government of Japan on industrial policy.52 A Houdaille spokesman stated that the company is now “awaiting the outcome of these talks and considering its options.”53

The lack of a formal opinion by the U.S. Government, elaborating on reasons for denying relief, suggested that the decision may have been politically motivated. It also left unanswered numerous questions as to whether Section 103 of the Revenue Act of 1971 could serve as a new trade remedy to restrict imports into the United States. Several of those issues will now be addressed.

II. Issues Raised by the Houdaille Case

As already noted, the Houdaille petition represented the first time that a party had invoked Section 103 of the Revenue Act of 1971 as a trade remedy. That fact alone made the case significant. The trade bar eagerly awaited the Government’s decision with the hope of learning what factors the Government deemed significant in a Section 103 case and whether Section 103 might become a powerful, new trade remedy for domestic industries attempting to restrict imports into the United States. The Government’s two-paragraph announcement of its decision, however, fell far short of fulfilling those expectations. Indeed, the decision left many issues open and the trade bar continues to speculate about the significance of Section 103 as a trade remedy.

reported that the Commerce Department has made an affirmative recommendation for import relief to President Reagan.

52 See supra note 3. According to various press reports, government groups supporting the Houdaille petition included representatives from the USTR and some sections of the Commerce and Defense Departments. On the other hand, representatives from the Treasury, Justice, and other sections of the Commerce and Defense Departments, as well as representatives from the Office of Management and Budget, and the Council of Economic Advisers consistently opposed the granting of relief under § 103. See 81 DAILY REP. FOR EXECUTIVES LL-2 (BNA) (April 26, 1983); 56 DAILY REP. FOR EXECUTIVES LL-1, 2 (BNA) (Mar. 22, 1983); Wall St. J., Mar. 29, 1983 at 1, 33.

It has been reported that there was unanimous agreement at the subcabinet level that the facts were sufficient to warrant a Presidential finding that Japan had engaged in a series of "unjustifiable, unreasonable or discriminatory" acts, each of which burdened or restricted U.S. commerce, that these conclusions were endorsed at the cabinet level, and that the final decision to deny any relief to Houdaille was made by President Reagan at the request of Prime Minister Nakasone of Japan, in order to avoid embarrassing the Prime Minister prior to the June elections in Japan. Copaken, supra, note 1, at 212. It should be noted that Mr. Copaken represented Houdaille in the Section 103 proceeding. Id. at 213 n.9.

53 Latona Testimony, supra note 8, at 2. The spokesman added that it is still possible that Houdaille may file an action under § 301 of the Trade Act of 1974, 19 U.S.C. § 2411(a)-(b) (1982). Id. at 1. See supra note 42.
A. Is Section 103 Intended to Apply to Government Actions Which Promote Exports to the United States as Well as Those Which Inhibit Exports from the United States?

The provision of Section 103 which Houdaille sought to invoke is that part which forbids a foreign country from "engag[ing] in discriminatory or other acts (including tolerance of international cartels) or policies unjustifiably restricting United States commerce . . . ."\(^{54}\) In its petition, Houdaille attempted to interpret this prohibition as permitting the President to retaliate against action by a foreign government which unjustifiably causes "a curtailment of sales by U.S. companies or the displacement of such business by sales of foreign products."\(^{55}\)

In support of the Houdaille argument, it is true that the term "United States commerce," which is used in the relevant provision of Section 103, normally applies to U.S. domestic commerce as affected by both imports and exports. But an examination of the express language of congressional reports and statements accompanying the enactment of Section 103, as well as similar reports relating to Section 252(b) of the Trade Expansion Act of 1962 (from which the language of Section 103 was borrowed), clearly indicates that Congress intended Section 103 to apply only to actions of foreign governments which unjustifiably restrict U.S. exports; Congress did not contemplate that the statute would be used to retaliate against activities designed to promote imports to the United States.

The actual language in question in Section 103 was added by the members of the Conference Committee considering the Revenue Act of 1971. The report of that Committee does not elaborate on the meaning of the language used. However, a congressional summary of the new statute stated that it gave the President authority to exclude imported goods from the investment tax credit "with respect to the products of any country that maintains non-tariff trade restrictions (including variable import fees) which substantially burden, discriminate against or unjustifiably restrict United States commerce."\(^{56}\) Moreover, when presenting the Act as reported out of the Conference Committee, Representative Wilbur Mills, then Chairman of the House Ways and Means Committee,\(^{57}\) stated on the floor of the House of Representatives that under Section 103 the President could withdraw the investment tax credit with respect to prod-

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\(^{55}\) Petition, supra note 1, at 44 (emphasis added).


\(^{57}\) The House Ways and Means Committee was the committee in the House responsible for considering the bill which became the Revenue Act of 1971.
ucts from a country which "maintains burdensome non-tariff trade restrictions against U.S. exports or engages in discriminatory actions or policies which unjustifiably restrict U.S. exports."  

Further support for the proposition that Congress intended the authority under Section 103 to be exercised only to retaliate against restrictions imposed by foreign countries on U.S. exports comes from the Finance Committee's Report on the Senate's version of Section 103, which was presented to the Conference Committee. The Senate Report stated:

It is expected that the President, in deciding which types of foreign produced articles to make eligible for the investment credit, will take into account differences in the way similar (or perhaps different) classes of articles are treated by the foreign country in the case of imports from the United States. In the case of motion pictures, for example, it is anticipated that the extent to which foreign produced motion pictures become eligible for the investment tax credit will be made dependent, to a substantial degree, on whether the foreign country discriminates either against the U.S. motion picture showings in its country or discriminates in favor of its domestically produced motion pictures.

Similarly, Senator Russell Long, Chairman of the Senate Finance Committee, stated at the time that Section 103 would empower the President to "deny the investment tax credit for equipment from a country where, for example, they are discriminating against the United States with regard to the same commodity."

Finally, support for the view that Section 103 is directed only against activities which inhibit U.S. exports is provided by the language and legislative history of Section 252(b) of the Trade Expansion Act of 1962. The Conference Committee which reported the Revenue Act of 1971 noted that "[t]he trade restrictions and discriminatory acts referred to by [Section 103] are the same as those contained in Section 252(b) of the Trade Expansion Act of 1962." When Section 252(b) had been enacted, the Senate Finance Committee explained its meaning as follows: "Subsections (a) and (b) of section 252 of the bill together authorize action against burdensome foreign import restrictions." Moreover, the heading of Section 252 as enacted was "FOREIGN IMPORT RESTRICTIONS." Again, this suggests that it was only directed at activi-

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58 117 CONG. REC. 45,855 (1971) (emphasis added).
60 The Senate Finance Committee was the committee in the Senate responsible for considering the bill which became the Revenue Act of 1971.
61 117 CONG. REC. 42,664 (1971).
62 H.R. REP. NO. 708, 92d Cong., 1st Sess. 36 (1971). The only difference between the two statutes is in the type of retaliation they authorize the President to take. Under the Trade Expansion Act of 1962, Pub. L. No. 87-794, § 252(b)(2), 76 Stat. § 872, 879 (repealed 1975), which was reenacted in expanded form as Section 301 of the Trade Act of 1974, the President could impose restrictions in the form of quotas or increased tariffs on the importation of goods from the country concerned. The remedy under § 103, of course, is to deny the investment tax credit.
ties of foreign governments which restrict imports into their country from the United States, and not at actions designed to stimulate exports from the foreign country to the United States. Indeed, when Section 252 was reenacted and expanded in Section 301 of the Trade Act of 1974 to cover subsidies on products exported to the United States, the House Committee on Ways and Means noted that: "Section 252 of the 1962 act . . . restricts the authority to deal with unfair practices against U.S. industrial exports . . . ."\(^65\)

**B. Is Section 103 Intended To Be Directed at the "Industrial Policy" of Other Countries?**

Many of the activities about which Houdaille complained so vociferously could be viewed as nothing more than the successful application of industrial policy by the Government of Japan. Indeed, Houdaille objected to activities which were undertaken at the direction of MITI, and which were in accordance with the authority granted by the three Temporary Measures Laws and the Export and Import Trade Law. The U.S. Government has generally avoided enacting and implementing legislation comparable to those Japanese laws. The United States has never officially endorsed an "industrial policy," in the belief that the marketplace is the most effective allocator of resources.\(^66\) However, the United States must recognize that many other industrialized countries, such as Japan, do not share this laissez-faire attitude and, in fact, have established industrial policies. The issue, of course, is how U.S. trade law should respond to these actions by foreign governments.

U.S. trade law does seek to prevent the results of certain foreign government industrial policies from having an adverse impact on U.S. business, by providing a regulatory mechanism between those policies and the domestic marketplace. The traditional import relief laws are directed at offsetting the effects of specifically defined "unfair trade practices," such as subsidization or unfairly low pricing, at providing temporary relief where an industry is seriously threatened by imports, or at providing such relief when an article is being imported in sufficient quantities as to threaten the national security of the United States.\(^69\)

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\(^64\) Section 103 has not been broadened in this way.


\(^66\) There are of course a number of exceptions to this, such as the government bail-outs of Chrysler and Lockheed. A number of government officials and commentators believe that the U.S. Government will have to play a greater role in the allocation of resources if the United States is to remain competitive in the world marketplace. See, e.g., Weil, *U.S. Industrial Policy: A Process in Need of a Federal Industrial Coordination Board*, 14 LAW & POL'Y INT'L BUS. 981 (1983).


These laws each provide a form of relief which is targeted at a specific problem and is designed to remedy that problem without imposing any sort of punitive measures. To interpret Section 103 as permitting retaliation against the industrial policy of foreign governments would be quite different.

Using the denial of the investment tax credit under Section 103 as a means of responding to the effects of another country's industrial policy would be a radical change in U.S. trade law for at least two reasons. First, unlike other trade laws, Section 103 would be aimed not against a specific problem—such as a government subsidy—but against broad governmental policies encompassing a variety of programs, with no clear causal relationship between particular programs and the alleged unjustifiable effects. The degree to which the Section 103 remedy might call into question a wide range of the foreign government's programs would doubtless antagonize the foreign government and lead to charges against the United States of undue interference with the internal policies of the foreign government.

Second, also unlike other trade laws, the relief granted by Section 103 is not moderated by the degree of harm that has been caused. Most of the traditional import relief laws are designed so that at least in theory the relief granted is tailored to the amount of harm caused by the imports. The relief afforded by Section 103, denial of the investment tax

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70 However, at least in part due to the publicity given to the targeting issue by the Houdaille case, the Subcommittee on Trade of the House of Representatives Committee on Ways and Means has reported out a trade bill which includes a provision on targeting. Under this provision, the countervailing duty statute would be expanded to include any "export targeting subsidy," defined as "any government plan or scheme consisting of coordinated actions... that are bestowed on a specific enterprise, industry, or group thereof... the effect of which is to assist the beneficiary to become more competitive in the export of any class or kind of merchandise." According to the report, examples of "export targeting subsidies" include the exercise of government control over banks that would require diversion of private capital on favorable terms to specific beneficiaries, government involvement in promoting or encouraging anticompetitive behavior, such as relaxation of antitrust rules, and special protection of the home market to permit the development of competitive exports. **Subcomm. on Trade of the House Comm. on Ways and Means, 98th Cong., 2d Sess., Report on H.R. 4784: Trade Remedies Reform Act of 1984, at 18-19 (Comm. Print 1984.).** The new provision would require the Department of Commerce to use a method of calculation which to the extent possible reflects the full benefit of the subsidy to the beneficiary over the period during which the subsidy has had an effect. *Id.* at 19.

71 For example, antidumping and countervailing duties are designed to offset the amount of less-than-fair-value margins and subsidies, respectively. In a Section 201 proceeding, the International Trade Commission is required to determine the amount of relief "which is necessary to prevent or remedy" the injury. **Trade Act of 1974, §201(d)(1)(A), 19 U.S.C. § 2251(d)(1)(A) (1982).** Other import relief laws provide the President with discretion to take those steps he deems appropriate to remedy the trade problem. *See, e.g., Trade Act of 1974, §301, 19 U.S.C. § 2411 (1982); Trade Expansion Act, §232(b), 19 U.S.C. § 1862(b) (1982).** The targeting provisions of the legislation recently reported out by the Trade Subcommittee of the House Ways and Means Committee would require the imposition of a countervailing duty in an amount equal to the benefit received by the exporting companies from the practices at issue. *See supra note 70.*
credit, is not correlated in any way to the degree of harm suffered by U.S. industry due to the challenged activities.

Thus, it does not seem appropriate to use Section 103 to combat the industrial policy of other countries. To permit the use of Section 103 in a case such as that brought by Houdaille would be to provide an unwieldy remedy which excessively interferes with a broad range of the internal policies of a foreign government, and is sensitive neither to the particular acts causing the trade problems nor to the degree of harm which has resulted. These concerns are especially troublesome because there is no evidence in the legislative history of the statute that it was intended to have such a sweeping application. Section 103 relief under these circumstances might have an adverse effect on United States purchasers that would be out of all proportion to whatever damage was being caused to U.S. producers.

C. Should Relief Be Granted Under Section 103 Against Practices Which May Be More Appropriately Dealt With Under Other Statutes?

The decision whether or not to grant relief under Section 103 is a matter of total discretion with the President. His failure to take action would not normally be subject to judicial review. For some of the very reasons discussed in the previous subsection, it may be appropriate for the President, in deciding whether or not to exercise his discretion, to consider whether the petitioner could have sought relief which was more closely tailored to the actions about which it complained.

For example, as noted above, the petition alleged that the Japanese machine tool industry received a number of concessionary loans and outright grants from various governmental and quasi-governmental agencies. Such loans and grants would almost certainly be covered by the U.S. countervailing duty statute. If the loans and grants were determined to be "subsidies" within the meaning of the statute, and such subsidies had caused "material injury" to the U.S. industry, they would be

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72 Some of the other import relief statutes similarly confer discretion on the President. Trade Act of 1974, § 201, 19 U.S.C. § 2253 (1982) (the "escape clause") gives the President the power to reject a recommendation by the International Trade Commission for import relief, although such a rejection is subject to congressional override. The President may override an ITC decision to impose relief under the Tarriff Act of 1930, § 337, 19 U.S.C. § 1337 (1982), and in this case there is no congressional override. The antidumping and countervailing duties statutes, on the other hand, give no discretion to the executive branch. If there is a finding of less-than-fair-value selling or subsidization on the one hand, and material injury on the other, dumping or countervailing duties must be imposed. See 19 U.S.C. §§ 1671, 1673 (1982).

73 It is possible that had the President stated that his sole reason for declining to take action was that the statute did not cover the kind of activity challenged, the petitioner could have obtained review in the courts. See generally Sneaker Circus, Inc. v. Carter, 457 F. Supp. 771, 791 & n.25 (E.D.N.Y. 1978).

74 Deferral of Japanese income tax on export earnings and preferential financing by Japanese Government agencies have been held to be subsidies within the meaning of the countervailing duty law. See, e.g., Certain Scales and Weighing Machinery From Japan, 45 Fed. Reg. 19,590 (1980).
offset by additional duties imposed on future imports. Obviously this is a much more specific remedy than the lifting of the investment tax credit.75

The petitioner argued at some length that the encroachment of imports from Japan "seriously compromises the defense and security of the nation," because n.c. machining centers and n.c. punching machines are essential for the manufacture of weapons systems and other defense equipment.76 Section 232 of the Trade Expansion Act of 1962 specifically authorizes the President "to adjust the imports" of any article where he determines that the article is being imported into the United States "in such quantities or under such circumstances as to threaten to impair the national security."77 Indeed, shortly before the Government ruled against Houdaille under Section 103, the NMTBA invoked Section 232 of the Trade Expansion Act of 1962 in instituting an action against machine tool importers.78 If the NMTBA prevails in its case, then the remedy imposed will be directly related to relieving the harm caused by a particular problem, i.e., the impairment of the national security by the importation of machine tools.

Another possible avenue of relief would be Section 201 of the Trade Act of 1974, which authorizes the President to impose import relief where a domestic industry is being seriously injured by increased imports.80 Houdaille claims that "the precipitous decline in market share suffered by the domestic machine-tool producers may lead, if present trends continue, to the collapse of the industry."81 If that claim is correct, there might well be a good case for relief under Section 201. The odds of success under this statute are not very great, however; import relief has in fact been granted in only one quarter of the Section 201 cases brought since 1974.82

The United States trade laws do not, of course, establish a pecking order for the appropriate statute to be invoked in situations where more than one statute may be applicable. Nor do those laws necessarily limit the number of statutes which can be invoked. In at least one trade case,

75 One reason why Houdaille may have preferred Section 103 is that it may have believed that it would have been difficult to show "material injury" under the countervailing duty statute. See generally infra notes 97-104 and accompanying text.
76 Petition, supra note 1, at 143.
77 Id. at 142-50.
79 NMTBA petition, supra note 50.
81 Petition, supra note 1, at 144.
however, the President decided not to grant relief on the ground that relief was available under another statute. In *Welded Stainless Steel Pipe and Tube*,83 a case under Section 337 of the Tariff Act of 1930,84 the International Trade Commission had based its affirmative decision on its finding that the respondents had made sales in the United States below the variable cost of production. In his decision disapproving the Commission's determination, the President noted that relief against such sales was available to the petitioner under the antidumping statute.85 There is some basis, therefore, for the principle that the remedy which is least intrusive to notions of free trade should be the one imposed first.

It could be argued, of course, that *Welded Stainless* is not a precedent for a case such as Houdaille, for at least two reasons. First, in the *Welded Stainless* case a separate antidumping investigation by the Treasury Department was already in progress when the Section 337 action was instituted.86 Second, the only actions covered by the Section 337 decision were sales below cost, which were also covered by the antidumping investigation. Houdaille, on the other hand, alleged a whole series of "unjustifiable" actions, only some of which are covered by other statutes.

Nevertheless, if the President had lifted the investment tax credit in response to the Houdaille petition, Houdaille or other members of the U.S. machine tool industry would still have been permitted to file subsequent petitions under other statutes, such as the countervailing duty or national security provisions,87 and obtain additional relief. This would raise the spectre of "multiple legal harassment," a matter of some controversy in the trade relations between the United States and Japan. It seems desirable, therefore, to limit resort to multiple trade remedies by requiring that less intrusive statutes be utilized first. This would make relief under Section 103 appropriate only when remedies such as countervailing duties are either not available or have been exhausted.

D. Should Section 103 Be Invoked in the Case of Past Conduct?

Many of the actions about which Houdaille seemed to be most concerned took place a number of years ago. For example, the MITI directive that companies cease making those products for which they had

86 Although the Treasury Department did subsequently find that there had been sales at less than fair value, the International Trade Commission made a no-injury determination, so that no dumping duties were imposed. See 43 Fed. Reg. 32,468 (1978).
87 The National Machine Tool Builders' Association actually initiated its action under the Trade Expansion Act of 1962, § 232, 19 U.S.C. § 1962(b), prior to a decision in the Houdaille case. Interestingly, the complaint in the NMTBA case does not mention the Houdaille petition.
small market shares was issued in 1968. The industry association's power to veto the introduction of new types of products by individual manufacturers was replaced in 1970 by a system of notification and conciliation. An export tax exemption complained of in the petition was withdrawn in 1964. Many of the concessionary loans by various governmental and quasi-governmental agencies were made in the 1950s and 1960s. So far as one can tell from the petition, the MITI directives in effect today are confined largely to such relatively innocuous matters as the encouragement of standardization and the improvement of distribution channels.

The Japanese Government argued in response to the Houdaille petition that it would be improper to penalize Japan's machine tool industry today for actions which may have benefited it in the past, but which are no longer taking place. Otherwise, the industry would always be under a stigma which could never be fully removed. Indeed, not only are the present actions of the Japanese Government few in number, many of them are broadly similar to those followed by the U.S. Government. Houdaille responded that the Japanese industry occupies its strong position today because of its allegedly unjustifiable acts in the past; however, that argument alone does not seem to warrant imposition of the Section 103 remedy now.

Under other U.S. trade laws, once a petition is filed, the government begins an investigation in accordance with the particular legal remedy invoked. For example, under the countervailing duty law, the Department of Commerce would ultimately have to determine whether or not a subsidy is being provided with respect to the merchandise in question, and the International Trade Commission would ultimately have to decide whether the domestic industry is materially injured, or is threatened with material injury. The investigation and subsequent determinations

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88 Petition, supra note 1, at 63-64.
89 Id. at 73-76.
90 Id. at 97-98.
91 Id. at 103.
92 It should be noted, however, that Houdaille asserted in comments submitted subsequent to the petition that the funds given to the Japanese machine tool industry from the proceeds of bicycle and motorcycle race wagering are currently quite substantial — nearly 113 million dollars annually. Petition to the President of the United States through the Office of the United States Trade Representative for the Exercise of Presidential Discretion Authorized by Section 103 of the Revenue Act of 1971, 26 U.S.C. § 48(a)(7)(D), Comments by the Petitioner, at 3 (July 31, 1982) [hereinafter cited as Comments by the Petitioner].
95 See 19 U.S.C. § 1671(d).
are of course made with regard to current imports, not those of years past. This is in accord with the principle of directing relief against the particular harm now being caused by a particular trade problem. The same principle should apply to the use of Section 103.

A further argument against the use of Section 103 for past actions is that its primary purpose was to give the President power to bargain with other countries over the removal of discriminatory actions against U.S. products. This purpose would not be served by the taking of retaliatory action where the practices complained of had already ceased.

E. What is the Appropriate Injury Standard Under Section 103?

The relevant provision of Section 103 applies to acts or policies of foreign governments which have the effect of “unjustifiably restricting United States commerce.” This language indicates only that some degree of adverse effect on U.S. companies must be shown before the President may take action under this provision.

The only allegation of harm in the Houdaille petition was that imports from Japan have captured a substantially increased share of the domestic machine tool market. The petition claimed that between 1976 and 1981 Japanese imports of n.c. machining centers rose from 3.7 percent to 50.1 percent of the units in the market, and imports of n.c. punching machines rose from 4.7 percent to 37.6 percent. However, tables in the petition also revealed that, although U.S. manufacturers have lost a corresponding percentage share of the United States market, they have in fact expanded their sales in absolute terms quite dramatically over the same period:

<table>
<thead>
<tr>
<th></th>
<th>1976</th>
<th>1981</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Manufacturers' Sales of N.C. Machining Centers</td>
<td>1,225 units</td>
<td>2,120 units</td>
</tr>
<tr>
<td>Sales of N.C. Machining Centers</td>
<td>$189.8m.</td>
<td>$512.0m.</td>
</tr>
<tr>
<td>U.S. Manufacturers' Sales of N.C. Punching Machines</td>
<td>274 units</td>
<td>477 units</td>
</tr>
<tr>
<td>Sales of N.C. Punching Machines</td>
<td>$33.1m.</td>
<td>$95.6m.</td>
</tr>
</tbody>
</table>

96 During the floor debate on Section 103, Senator Russell Long, the floor manager of the bill, stated: “There are all sorts of discriminations against American manufacturers, so where it is desirable the President should have this too. He could deny the tax advantage of investment tax credit to the other country’s commodity if they do not discontinue their discrimination against our commodity.” 117 Cong. Rec. 42,664 (1971) (emphasis added).


98 A number of petitions have been filed under the similarly worded Trade Act of 1974, § 301, 19 U.S.C. § 2411(a)-(b) (1982). However, the issue of the degree of injury necessary to establish a case under Section 301 does not seem to have come up in any of them. It is impossible to be certain about this because the Government does not publish detailed statements of reasons supporting its determinations under Section 301.

99 These increases in market share of units of the respective machine tools correspond to an increase in dollar value market share from 2.1 percent in 1976 to 38.2 percent in 1981 for n.c. machining centers, and from 5.8 percent in 1976 to 37.1 percent in 1981 for n.c. punching machines. See Petition, supra note 1, at 125.

100 Projected on basis of first nine months. Id.
It is clear from this table that the market in the United States for the products in question has been expanding rapidly since 1976. While the import penetration figures show that Japanese imports have enjoyed a disproportionate share of the expansion, the petition did not allege that U.S. manufacturers have lost sales or suffered from depressed profits or surplus capacity—typical indicia of injury in traditional import relief cases—as a result of the imports from Japan.

There is, of course, a broad spectrum of possible approaches to the injury question. At one extreme, it could be argued that where the actions complained of are comparable to acts that would be declared per se illegal under the U.S. antitrust laws, they should be considered by their very nature to have the necessary restrictive effect on U.S. commerce, so that no specific showing of adverse effect should be necessary. This was in fact Houdaille's primary position, and the discussion in the petition of loss of market share by the U.S. industry was simply designed to buttress the case for import relief.

The other extreme would be a test similar to either the "serious injury" test under Section 201 of the Trade Act of 1974, which requires injury "of grave or important proportions," or, slightly less severe, the "material injury" test contained in the countervailing duties and antidumping laws. In either case, a mere showing of loss of market share would probably not be sufficient for an affirmative finding. The petitioner in such a case would almost certainly have to show other adverse effects of the import competition, such as loss of specific sales, price suppression, decline of profits, or lowered capacity utilization.

It is unlikely that Congress, without specifically so providing, intended such a stringent "injury" test under Section 103. On the other hand, it would seem inappropriate for the President to take the drastic step of removing the investment tax credit from imported products without some showing of harm to the competing domestic industry. If the per se rule urged by Houdaille had been adopted, the investment tax credit could have been lifted in a situation where the imports might have had no impact on the domestic industry because that industry was already working to capacity and could not meet additional orders. In this situation, U.S. purchasers of the product in question would be harmed by the lifting of the tax credit, and the United States would expose itself to possible international repercussions, without any offsetting benefit to the petitioning industry. Thus, it seems appropriate for the U.S. Government, before acting on a petition under Section 103, to satisfy itself that

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101 Certain activities, such as price-fixing and market-sharing among competitors, are regarded as so inherently anticompetitive that they are automatically treated as illegal under the antitrust laws. It is no defense to show that such activities did not in fact have an adverse effect on competition. See United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

102 Petition, supra note 1, at 46-47, 139-42.


the domestic industry has been adversely affected in some fashion by the imports in question.

F. Would Application of Section 103 Violate the International Obligations of the United States?

The Houdaille petition conceded\(^\text{105}\) that at first glance the relief sought would appear to violate both the "national treatment"\(^\text{106}\) and the "most-favored-nation" principles of the General Agreement on Tariffs and Trade (GATT),\(^\text{107}\) as well as Article XVI(1) of the U.S.-Japan Treaty of Friendship, Commerce and Navigation (the FCN Treaty), which requires each party to give national treatment\(^\text{108}\) and most-favored-nation treatment\(^\text{109}\) to the products of the other party. The petition claimed, however, that Section 103 action was justified in this case under the national security exception in Article XXI of GATT and in Article XXI(1) of the FCN Treaty.\(^\text{110}\)

The relevant part of Article XXI of GATT provides that nothing in GATT shall be construed to prevent any contracting party from taking action which it considers necessary for protection of its essential security interests. Essential security interests are those "relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment."\(^\text{111}\) The petition claimed that Ar-

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\(^{105}\) Petition, supra note 1, at 158.

\(^{106}\) The national-treatment principle is embodied in Article III(2) of GATT. That principle requires that imports "not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products." General Agreement on Tariffs and Trade, opened for signature Oct. 30, 1949, art. III, 61 Stat. A3, A18, T.I.A.S. No. 1700 [hereinafter cited as GATT].

\(^{107}\) The most-favored-nation principle is embodied in Article 1(1) of GATT. That principle requires that equal treatment be given to imports from all members of the GATT. Id. art. 1, 61 Stat. at A12, T.I.A.S. No. 1700.

\(^{108}\) Article XXII(1) of the FCN Treaty defines "national treatment" in the case of products to mean "treatment accorded within the territories of a Party upon terms no less favorable than the treatment accorded therein, in like situation, to . . . products . . . of such Party." Treaty of Friendship, Commerce and Navigation, April 2, 1953, United States-Japan, art. XXII, 4 U.S.T. 2079-80, T.I.A.S. No. 2863. [hereinafter cited as Japan FCN treaty].

\(^{109}\) Article XXII(2) of the Japan FCN Treaty defines "most-favored-nation treatment" as treatment no less favorable than that accorded to products of any third country. Id.

\(^{110}\) The petition also asserted that as a matter of U.S. domestic law, neither GATT nor the Japan FCN Treaty can prevail over § 103, which was enacted after conclusion of the Treaty and adoption of GATT. Petition, supra note 1, at 156-57. However, § 7852(d) of the Internal Revenue Code provides that "[n]o provision of [Title 26] shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of this title [August 16, 1954 —when both GATT and the FCN Treaty were already in effect]." 26 U.S.C. § 7852(d) (1982). In any event, it seems highly unlikely that the President would take discretionary action that would violate international obligations of the United States, and would require the United States to provide compensation or face retaliation, particularly at a time when the United States is itself seeking to enforce GATT more vigorously than ever before. See GATT, supra note 106, art. XXIII, 61 Stat. at A64, T.I.A.S. No. 1700.

\(^{111}\) Article XXI(1) of the Japan FCN Treaty is a similar national security provision. Moreover, Article XXI(3) of the Japan FCN Treaty incorporates by reference the national security
article XXI applied to the present case because n.c. machining centers and n.c. punching machines are essential for the manufacture of weapons systems and other defense equipment.\textsuperscript{112}

Commentators on GATT have observed that although a national security exception to GATT is clearly necessary, the self-judging exception in Article XXI provides an easy excuse for protectionist policies. Kenneth Dam has written:

One danger is that the national security argument is almost infinitely expandable. Protectionist claims based on national security interests are put forth not only for products used by the military but also for civilian products. . . . The arguments favoring such restrictions are based on the notion that the product in question is produced by an industry that also supplies the military and that would in time of war be called upon greatly to expand its production. . . . In times of competitive pressure, almost every industry can produce an argument along national security lines.\textsuperscript{113}

John Jackson, another noted expert on GATT, has also warned that Article XXI constitutes "a dangerous loophole to the obligations of the GATT."\textsuperscript{114}

The U.S. Government would have to scrutinize a national security claim with great care before relying on it to avoid obligations under GATT and under an FCN Treaty.\textsuperscript{115} Indeed, the national security provision has been officially invoked only once in the history of GATT. That instance came in 1949, when Czechoslovakia brought a complaint against the imposition of U.S. export controls, and the United States used Article XXI to defend its action.\textsuperscript{116}

There is some question, however, as to whether Article III(2), the national treatment provision of GATT, even applies to income taxes at all, as opposed to taxes on products.\textsuperscript{117} This issue does not appear to have been formally resolved by GATT.\textsuperscript{118} One of the leading commentators on GATT takes the view that Article III(2) does not apply to income tax,\textsuperscript{119} while another leaves the question open.\textsuperscript{120}

\textsuperscript{112} Petition, \textit{supra} note 1, at 160-61.
\textsuperscript{115} The U.S. Government has required petitioners to make a strong showing of harm to the national security in cases filed under the Trade Expansion Act of 1962, § 232, 19 U.S.C. § 1862 (1982). Indeed, although a number of petitions have been filed, relief has been granted in only one case, that involving imports of oil.
\textsuperscript{116} J. JACKSON, \textit{supra} note 114, at 749.
\textsuperscript{117} The investment tax credit provided by Section 38 of the Internal Revenue Code, 26 U.S.C. § 38 (1982), is available as a credit against income tax.
\textsuperscript{118} Houdaille argued at length in comments it submitted in support of its Petition that the preparatory work of Article III of GATT demonstrates that income taxes and exemptions therefrom were not intended to be subject to Article III. \textit{See Comments by the Petitioner, supra} note 92, at 35-64.
\textsuperscript{119} K. DAM, \textit{supra} note 113, at 124.
\textsuperscript{120} J. JACKSON, \textit{supra} note 114, at 284-85.
Even if Article III(2) does not apply to income tax benefits granted to purchasers of domestic but not foreign goods, a good argument can be made that Article III(4) of GATT does apply. Article III(4) requires national treatment for imported goods "in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use." In one case GATT held that the granting by the Italian Government of special credit terms to purchasers of domestic but not imported farm equipment violated Article III(4). There is little difference in principle or effect between favorable credit terms granted to purchasers of domestic goods and favorable income tax treatment. A decision that one practice was banned by Article III while the other was not would permit highly discriminatory treatment of imports based on a rather technical distinction, and would again create a major loophole in GATT.

III. Conclusion

Regardless of the motive, the U.S. Government acted properly in denying relief to Houdaille under Section 103 of the Revenue Act. There is a serious question whether Section 103 was intended to apply to the type of activities complained about in the Houdaille petition: predominately past conduct involving the application of industrial policy by the Government of Japan that was intended to promote exports of machine tools from Japan rather than inhibit imports of those products into Japan. In addition, the contention that the U.S. machine tool industry is being harmed by imports from Japan appears, at least from the petition, to be rather weak. Moreover, other trade remedies seem to be more closely tailored to respond to the particular problems alleged in the petition. Finally, the U.S. Government would have been quite reluctant to take action which might be challenged under both GATT and the FCN Treaty, relying solely on the national security exceptions or upon the technical argument that discriminatory provisions relating to income tax are not covered by GATT.

This is not to say that Section 103 would never be applicable as a trade remedy. In limited circumstances Section 103 may provide the most appropriate relief available. Such a circumstance would probably involve a situation in which the foreign government in question is currently taking steps to restrict imports from the United States, and other U.S. trade remedies did not provide adequate relief to counter this behavior. If the domestic industry could then demonstrate a sufficient degree of injury, the retaliatory remedy available under Section 103 of

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123 The petition estimated that if the investment tax credit is removed from Japanese machine tools, the price would have to be lowered by about 15% to match the loss of the tax benefit to the purchaser. Petition, supra note 1, at 155.
denying the investment tax credit to certain imported products might be justified. There would be no violation of any international agreements if the foreign country involved were not a GATT signatory or an FCN Treaty partner. If the foreign country did belong to GATT, then ideally the United States would first attempt to exhaust the dispute resolution procedures provided in Articles XXII and XXIII before acting under Section 103.

The Houdaille petition, however, was not such a case. Nevertheless, Houdaille and other members of the U.S. machine-tool industry probably benefited from the filing of the petition. The petition caused a considerable stir in political circles, and stimulated interest in Congress. Indeed, bills were introduced that would have denied the investment tax credit to all imported products. By focusing attention on the problems facing the domestic machine-tool industry, Houdaille made it more likely that some relief may be granted, although it would not be in the form requested in the petition. More broadly, Houdaille forced the trade bar to examine the merits of the Section 103 remedy for the first time, increasing the likelihood that the remedy may be successfully invoked at some point in the future. Although Section 103 cannot be regarded as a major new trade remedy available to domestic industries seeking to restrict imports into the United States, neither can it be dismissed totally. Section 103 must be viewed as another, albeit limited, remedy in the arsenal of weapons available to those domestic industries.

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125 As already noted, the NMTBA petition filed under the Trade Expansion Act of 1962, § 232, 19 U.S.C. § 1862 (1982), is still pending before the U.S. Government. See supra notes 50-51 and accompanying text. See also supra note 70.